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No. 85-533

In The
Supreme Court of the United States
October Term, 1985

SILENT HOIST & CRANE CO., INC.,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

Under the Due Process and Commerce Clauses of the United States Constitution and the unitary business principle, may New Jersey impose its corporate franchise tax on an apportioned share of an out-of-state corporation's sales and investment income when the corporation's chief executive officer manages all facets of the business, the income in question is used in the other aspects of the business, and the investment income derives, not from subsidiaries, but from a diversified portfolio of securities?

TABLE OF CONTENTS

Page

COUNTERSTATEMENT OF QUESTIONS PRESENTED i

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 1

COUNTERSTATEMENT OF FACTS 2

ARGUMENT—THE PETITION FOR A WRIT OF *CERTIORARI* SHOULD BE DENIED BECAUSE, IN HOLDING THAT PETITIONER'S BUSINESS IS UNITARY, THE SUPREME COURT OF NEW JERSEY CORRECTLY APPLIED THE DECISIONS OF THIS COURT TO THE FACTS AND STATUTE BEFORE IT. 6

CONCLUSION 17

TABLE OF AUTHORITIES

Page

CASES CITED

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 *U.S.* 307 (1982), reh. den. — *U.S.* — 4, 5, 7, 8, 9, 10, 11, 13

Associated Dry Goods Corp v. Commissioner, 347 *N.W.*2d 36 (Minn. Sup. Ct. 1984), *cert.* den. — *U.S.* —, 105 *S.Ct.* 124 (1984) 15

Container Corporation of America v. Franchise Tax Board, 463 *U.S.* 159 (1983), reh. den. — *U.S.* — 4, 8, 9, 10, 11, 12, 13, 15, 16

Exxon Corp. v. Wisconsin Dep't of Revenue, 447 *U.S.* 207 (1980) 5, 7, 9, 10, 12

Mobil Oil Corp. v. Commissioner of Taxes, 445 *U.S.* 425 (1980) 6, 9, 10

Russell Stover Candies, Inc. v. Dept. of Rev. 665 *P.*2d 198 (Mont. Sup. Ct. 1983), app. dism'd — *U.S.* —, 104 *S.Ct.* 475 (1983), reh. den. — *U.S.* — 15

F.W. Woolworth Co. v. Taxation and Revenue Dep't of New Mexico, 458 *U.S.* 354 (1982), reh. den. — *U.S.* — 4, 5, 7, 8, 9, 10, 11, 13

UNITED STATES CONSTITUTION CITED

Amendment XIV, § 2 1

Article I, § 8, cl. 3 1

STATUTES CITED

N.J.S.A. 54:10A-1 *et seq.* 2

N.J.S.A. 54:10A-4(k)(1) 3, 11

N.J.S.A. 54:10A-8 6

15 *U.S.C.* § 381 16

TABLE OF AUTHORITIES—Continued

Page

SESSION LAW CITED

N.J. Laws 1982, *c.* 55 2

MISCELLANEOUS CITED

Report of the New Jersey Tax Policy Committee, Part V, "Non-property Taxes in a Fair and Equitable Tax System" (1972) 3

APPENDIX

Excerpt from New Jersey Corporation Business Tax Act (*N.J.S.A.* 54:10A-4(k)) ..... R.A. 1

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BRIEF IN OPPOSITION

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution, Amendment XIV, § 2

[N]or shall any State deprive any person of life, liberty, or property, without due process of law.

United States Constitution, Article I, § 8, cl. 3.

The Congress shall have power . . . to regulate commerce . . . among the several States. . . .

New Jersey Corporation Business Tax Act, *N.J.S.A.* 54:10A-1 *et seq.*, the revelant portion of which is printed at R.A. 1, *infra*.

COUNTERSTATEMENT OF FACTS

Petitioner Silent Hoist & Crane Co., Inc. is a New York corporation with its principal place of business and manufacturing plant in Brooklyn, New York (P.A. 15).* Its principal business is the design, manufacture and sale of sophisticated, custom-made materials-handling and hoisting equipment, such as equipment to handle ship containers. During the years involved (1971-1974), petitioner owned two parcels of industrial real estate in New Jersey, neither of which was directly used in petitioner's manufacturing business (P.A. 32). Additionally, petitioner held a diversified portfolio of securities (P.A. 32) consisting in large part of corporate stocks. Petitioner owned no more than a small fraction of the shares of any of the issuers contained in its portfolio (TB18-24 to TB19-12).**

New Jersey's corporation business tax (*N.J.S.A.* 54:10A-1 *et seq.*) is a franchise tax which is measured by a corporation's net worth (essentially book value)*** and

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* The designation "P.A." refers to petitioner's appendix.

** The designation "TB" refers to the trial transcript of October 22, 1982, in the New Jersey Tax Court.

*** The net worth portion of the tax is being gradually phased out. *N.J. Laws* 1982, *c.*55. While the net worth tax was in ef-

(Continued on following page)

net income. Three aspects of the tax are significant for purposes of this case. First, unlike many state corporation income taxes, the New Jersey corporation business tax includes in the income base (for purposes of measuring the value of the franchise) all income realized by a taxpayer and reported on its federal income tax return, with certain adjustments. No provision is made for allocating investment income to the corporate domicile (P.A. 13 to 14, quoting from the *Report of the New Jersey Tax Policy Committee*, Part V, "Non-property Taxes in a Fair and Equitable Tax System," 25 (1972)). Second, New Jersey excludes from the income base 50% of all dividends received and in the case of 80% or more owned subsidiaries excludes 100% of dividends received. *N.J.S.A.* 54:10A-4(k)(1) (R.A. 1). Once the income base has been determined, the standard three-factor apportionment formula, which takes into account property, wages, and receipts, is applied to apportion the income of a corporation doing business within and without the State. To this apportioned share of income is applied the tax rate. The third significant aspect of the tax is that New Jersey does not require or permit combined reporting under which the income of a unitary group of corporations is included in the base, their intercompany receipts (such as dividends) eliminated, and the total apportioned to the State by combining the apportionment factors of the in-

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(Continued from previous page)

fect during the years at issue, as pointed out by the New Jersey Supreme Court, petitioner is procedurally barred from claiming a refund of its net worth tax because it included its investment and manufacturing assets in its net worth base and failed to timely file a claim for refund excluding those assets (P.A. 12, n.3).

cluded corporations. *See Container Corporation of America v. Franchise Tax Board*, 463 *U.S.* 159 (1983) reh. den. — *U.S.* —.

Taking the position that its New Jersey real estate and the balance of its business conducted from its Brooklyn location were entirely separate activities, petitioner included on its New Jersey corporation business tax returns only the income and expenses related to its loss-producing New Jersey real estate. The New Jersey Division of Taxation audited petitioner's returns and added back to the income base both petitioner's sales income and its investment income, including 50% of the dividends received on the stocks held in petitioner's portfolio.

The New Jersey Tax Court ruled in petitioner's favor, relying on *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 *U.S.* 307 (1982), reh. den. — *U.S.* — and *F.W. Woolworth Co. v. Taxation and Revenue Dep't of New Mexico*, 458 *U.S.* 354 (1982), reh. den. — *U.S.* —, which were handed down shortly before the trial of this case. The Tax Court looked for control and functional integration *between* petitioner and the issuers of the stocks held by petitioner in its diversified securities portfolio and naturally found these elements to be lacking (P.A. 42 to 43). Moreover, the court found a lack of centralized management (P.A. 43 to 44) and rejected the other facts adduced by the State as evidence of a unitary business (P.A. 44 to 45). The trial court further concluded, despite clear evidence to the contrary, that petitioner had no presence in New Jersey other than its real estate (P.A. 32); the court disregarded the fact that petitioner's employees engaged in the solicitation of sales, design conferences, repairs, and customer training, all in New Jersey (P.A. 16 to 17 and

see TB51-18 to TB56-4; TB30; TB58-12 to TB60-4; TB87-22 to TB88-25).

The New Jersey Supreme Court reversed. It distinguished the factual situations presented in *ASARCO, supra and F.W. Woolworth, supra,* pointing out that those cases involved substantial amounts of dividends received from subsidiaries, thus justifying a concern that the inclusion of such dividends in the tax base without a correlative inclusion of the factors of the subsidiaries distorted the result unless a unitary relationship could be shown *between* the taxpayer and the dividend paying subsidiaries (P.A. 24, n.8). The New Jersey Supreme Court focused instead on relationships between petitioner's investment activity and the other aspects of petitioner's business (P.A. 20) and found that petitioner benefited "from an umbrella of centralized management and controlled interaction." *Exxon Corp. v. Wisconsin Dep't of Revenue,* 447 *U.S.* 207, 224 (1980) (P.A. 19). The New Jersey court ultimately concluded that petitioner's common management, mode of operation, and accounting demonstrated a sharing of value more than sufficient to establish the existence of a unitary business (P.A. 24 to 25).

While stating that it was not basing its holding on such ground, the New Jersey Supreme Court noted that, alternatively, even if petitioner's business were not unitary, the business had sufficient contacts with the State to justify imposition of the corporation business tax on petitioner's sales income (P.A. 26).

Finally, the court remanded the case to the New Jersey Tax Court to determine whether the apportionment formula operated unfairly in petitioner's case so as to

warrant a discretionery adjustment to petitioner's apportionment factor under *N.J.S.A.* 54:10A-8.*

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ARGUMENT

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE DENIED BECAUSE, IN HOLDING THAT PETITIONER'S BUSINESS IS UNITARY, THE SUPREME COURT OF NEW JERSEY CORRECTLY APPLIED THE DECISIONS OF THIS COURT TO THE FACTS AND STATUTE BEFORE IT.

Beginning with the 1980 Term, this Court undertook to resolve the controversy in the States concerning the taxation of investment income of nondomiciliary corporations. In *Mobil Oil Corp. v. Commissioner of Taxes,* 445 *U.S.* 425 (1980), the Court held that dividends received by a nondomiciliary corporation, in large part from foreign subsidiaries, could be subjected to an apportioned state tax if the dividends reflected "profits derived from a functionally integrated enterprise . . . earned in a unitary business." 445 *U.S.* at 440. So long as the nondomiciliary corporation had a nexus with the taxing state and the businesses of the nondomiciliary corporation and the payors of

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* Respondent agrees with petitioner (Pb8) that despite the remand by the New Jersey Supreme Court, this case is ripe for review by this Court because an adjustment to petitioner's apportionment factor would not affect the New Jersey Supreme Court's holding on the federal question, namely its conclusion that petitioner's business is unitary and that as a result petitioner's sales and investment income may, consistent with the Due Process and Commerce Clauses, be included in the *base* of the tax prior to application of the apportionment factor.

the dividend income were functionaly integrated, an apportioned tax on a share of those dividends violated neither the Due Process nor Commerce Clause. The Court was not called upon to set forth facts establishing the existence of a unitary business because Mobil did not attempt to show that its affiliates and subsidiaries were engaged in separate businesses. *Id.* at 439.

Exxon Corp. v. Wisconsin Dep't of Revenue, supra, involved the application of the unitary business principle to operating or divisional income of a nondomiciliary corporation. Rejecting the taxpayer's argument that, through its internal accounting systems, it could isolate profits from those of its divisions based outside the taxing state, the Court held that, if a business is unitary, a state tax apportionment formula may be applied to income from the entire business without regard to the corporation's internal accounting procedures. The Court found proof of a unitary business in Exxon's centralized management and the vertical integration of its operations.

In *ASARCO, Inc. v. Idaho State Tax Comm'n, supra,* and *F.W. Woolworth Co. v. Taxation and Revenue Dept. of New Mexico, supra,* the Court returned to the issue of the taxation of investment income received by a nondomiciliary corporation and concluded in both cases that there were insufficient connections between the corporate affiliates and subsidiaries paying the dividends and the taxpayer's activities in the taxing state to justify taxation of those dividends under formulary apportionment. In *ASARCO,* the Court found that the taxpayer did not control the subsidiaries and affiliates, that there was an insufficient flow of product between them to result in func-

tional integration, and concluded that the state could not establish the existence of a unitary business simply by arguing that the investments in question were held for the purpose of enriching the corporation.* In *Woolworth,* despite the fact that three of the dividend-paying subsidiaries were wholly owned and Woolworth owned 52.7% of the stock of the fourth, the Court similarly found a lack of actual operating control and also a lack of product flow indicative of functional integration.

Container Corp. of America v. Franchise Tax Board, supra, again took up the question of the taxation of subsidiary income in the return of a nondomiciliary corporation, but in the form of including the income *of* certain subsidiaries in a combined return as opposed to taxing the dividends paid by those subsidiaries to the taxpayer. Although there was an almost total lack of product flow between the taxpayer and its subsidiaries and virtually no day-to-day operational control, the Court nevertheless found that the taxpayer and its subsidiaries were engaged in a unitary business. Stepping back from the strict approach of *ASARCO* and *Woolworth,* the Court made the following points. First, the taxpayer, not the State, has the " 'distinct burden' of showing by 'clear and cogent evidence' that [the State tax] 'results in extraterritorial values being taxed.' " 463 *U.S.* at 164 and 175. Second, operational control and product flow are not the only indicia of a unitary business. *Id.* at 179. Rather, all

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* The Court noted that ASARCO had not challenged Idaho's taxation of interest and capital gains other than amounts attributable to the five corporations in question and that the Court did "not intimate views on such matters." 458 *U.S.* at 330, n.25.

that the unitary business concept requires is that the "out-of-state activities of the purported 'unitary business' be related in some concrete way to the in-state activities." *Id.* at 166. A concrete relationship is established by "some sharing or exchanging of value . . . beyond the mere flow of funds arising out of a passive investment . . ." *Ibid.* This sharing or exchange of value may not be "capable of precise identification or measurement. . . ." *Ibid.* Third, state tax statutes may take differing approaches to the unitary business issue by, for instance, exempting from tax dividends received by a nondomiciliary corporation, subjecting those dividends to tax using the apportionment factor of the recipient, or taxing the income of the dividend payors using an apportionment factor which combines the factors of the parent corporation and its unitary subsidiaries. *Id.* at 167-8. Fourth and finally, the Court will "defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary business' " provided such decision is " 'within the realm of permissible judgment.' " *Id.* at 175 and 176.

It is abundantly clear that the Supreme Court of New Jersey correctly applied the broad principles set forth in *Container Corporation* and *Exxon* to a very different set of facts and a different tax statute. The New Jersey court carefully pointed out that, as distinct from *Mobil, ASARCO, Woolworth* and *Cointainer,* petitioner's case involves, not the taxation of proportionately large amounts of dividend income received from subsidiaries and affiliates, or the taxation of the income of such subsidiaries in a combined report, but rather the taxation of dividends (and some interest) received from a diversified investment

portfolio (P.A. 18 and 20). Since subsidiary income is not involved, the New Jersey Supreme Court properly reasoned that the focus of the unitary business inquiry must be on the relationships between petitioner's various activities—manufacturing, investments, and real estate—rather than on the relationships between petitioner and the payors of its investment income (P.A. 20). This focus on unitary relationships within a single corporation is the only point of divergence between the New Jersey Supreme Court's approach to the unitary business concept and this Court's approach as delimited in *Mobil, ASARCO, Woolworth,* and *Container*. In those cases, as suggested *supra,* this Court had no reason to apply the unitary business principle within the confines of a single corporation since the facts did not warrant it. Moreover, a focus on unitary relationships within a single corporation is clearly sanctioned by the Court's decision in *Exxon* although the income there at issue was operating income rather than investment income.

Having focused the inquiry on the existence of unitary relationships between, on the one hand, petitioner's investment income and the management of its investments and, on the other, the rest of petitioner's business, the New Jersey court then followed the teachings of *Exxon* and *Container* to the letter. First, it found a strong, one-man, centralized management in charge of all three aspects of petitioner's business—manufacturing/sales, portfolio investments, and real estate (P.A.20 to 21) and *see Exxon,* 447 *U.S.* at 224. Nor could petitioner establish that any part of its business was a discrete operation (P.A. 21) and *see Exxon,* 447 *U.S.* at 224-225. The court noted that the real estate had been purchased with the intent to move petitioners plant to New Jersey, that funds to purchase

the property presumably were derived from petitioner's general corporate funds, that the real estate was maintained during certain years by the income generated in the manufacturing and investment aspects of the business, that the corporation had a single bank account, a single chart of accounts, and centralized administrative services (P.A. 21 to 22). All of these elements produced "a distinct sharing of . . . value . . . " (P.A. 24) within the meaning of *Container Corporation. See* 463 *U.S.* at 166.

In addition to focusing on the unitary relationships existing within petitioner, the New Jersey Supreme Court carefully noted that the New Jersey corporation business tax is quite unlike the Idaho tax addressed by this court in *ASARCO.* As distinct from a statute like Idaho's which permits the taxation of subsidiaries both through a combined report *and* through the inclusion of subsidiary dividends in the base, the New Jersey tax falls extremely lightly on intercorporate dividends, exempting from tax those dividends received from 80% or more owned subsidiaries and including only 50% of other dividends received. *N.J.S.A.* 54:10A-4(k)(1) (R.A. 1 and P.A. 24, n.8). Moreover, the income of subsidiaries is never taxed in a parent corporation's return since New Jersey does not permit or require combined reporting (P.A. 24, n.8). Thus, as properly noted by the New Jersey court, the distortion and overtaxation which presumably concerned this Court in *ASARCO* and *Woolworth* are unlikely to arise under the New Jersey corporation business tax (and manifestly do not exist in petitioner's case). In short, New Jersey's tax provides a clear example of a statutory variation on the unitary business theme, the kind of variation which this Court sanctioned in *Container,* stating:

> A final point that needs to be made about the unitary business concept is that it is not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach. [463 *U.S.* at 167].

Similarly, in concluding that petitioner's manufacturing activity was unitary with the rest of petitioner's operations, the New Jersey court simply followed the tests set forth in *Container* and in *Exxon* (P.A. 25). As in *Exxon,* since petitioner's manufacturing income does not involve separate corporations, the focus of the unitary business inquiry must clearly be on the relationships between the manufacturing aspect of petitioner's business and petitioner's other operations. As in *Exxon,* the New Jersey Supreme Court found that one of the significant indicia of a unitary business was petitioner's strong centralized management (P.A. 25).

Petitioner's arguments in favor of granting the writ are not convincing. To begin with, petitioner misstates the facts. In maintaining that petitioner's "sole physical links" with New Jersey were its two parcels of industrial real estate (Pb4) and that the company "had no employees or payroll in New Jersey . . . " (Pb5), petitioner overlooks the trial transcript and the findings of the New Jersey Supreme Court to the effect that petitioner's employees visited New Jersey customers, attended design conferences in New Jersey, performed warranty work, showed customer personnel how to deal with problems, and removed defective pieces of petitioner's machinery, all at New Jersey locations (P.A. 16 to 17 and see the citations to the trial transcript, *supra* at 5). In maintaining that there is no

evidence in the record to support the New Jersey Supreme Court's statement that petitioner originally intended to move its manufacturing plant to New Jersey (Pb4 to 5), petitioner overlooks the trial testimony of its president to the effect that petitioner purchased one of the New Jersey parcels with the intent of moving its manufacturing plant there (TB 68-17 to 23; TB 31-18 to TB 32-16).

Second, petitioner mischaracterizes the New Jersey Supreme Court's opinion. That court did not hold that *Container Corporation* supplanted both *Woolworth* and *ASARCO*. (Cf. Pb7). The court merely stated that this Court has "modified its holding in ASARCO" (P.A. 17) and that *Container* suggests that *Woolworth* and *ASARCO* "can be confined to their specific facts." (P.A. 28). These statements are plainly correct. *Container* rejects the intimations in *ASARCO* and *Woolworth* that substantial product flow and day-to-day operating control are essential to the existence of a unitary business. 463 *U.S.* at 178-9 and 177. In describing the indicia of a unitary business as being an unquantifiable sharing or exchange of value, the Court in *Container* expanded the scope of the relevant criteria. Nor is petitioner correct in suggesting that the flow of value standard enunciated by this Court in *Container* has meaning only in the context of the flow of goods test (Pb11). The flow of value standard is a far broader concept encompassing the entire unitary business inquiry. *See* 463 *U.S.* at 166.

Petitioner suggests that the New Jersey Supreme Court improperly relied on the possibility that petitioner's real estate could be pledged or converted to other uses (Pb12) and on the presumption that funds to purchase pe-

titioner's New Jersey real estate were obtained from general corporate funds (Pb13), and maintains that the court in effect was returning to the "corporate purpose doctrine" (*Ibid*). While the court did say that petitioner's real estate was capable of being pledged or liquidated for other corporate purposes and that funds to purchase the real estate presumably came from the manufacturing and sales activity, these were only two of the many indicia of a unitary business. Responding to a similar argument made by Container Corp., this Court made clear that while potential, but unexercised control, is not dispositive of the unitary business question, that potential is relevant. 463 *U.S.* at 177, n.16. Combined with other factors, such as, in petitioner's case, a strong, one-man, centralized management and concrete evidence in petitioner's financial records of flows of funds between one corporate activity and another, the potential use of the securities portfolio and the presumed use of general corporate funds are relevant, although not dispositive, criteria in the unitary business inquiry. The New Jersey Supreme Court suggested no more (P.A. 20 to 23).

Similarly, while the existence of a single bank account (Pb14) cannot be the sole determinant of the existence of a unitary business, in the context of petitioner's case, it is plainly a relevant fact, to be considered along with other relevant facts. Indeed, the New Jersey Supreme Court would be the first to agree that each of the factors which it enumerated in its opinion, standing alone, would not be sufficient to establish a unitary business (P.A. 22 to 23). "Rather . . . it is the combination of these factors which

leads indisputably to the conclusion that [petitioner] is a unitary corporation" (P.A. 23).*

Nor is petitioner correct in suggesting that under the New Jersey Supreme Court's decision, a corporation that pays sales tax will be deemed subject to the corporate franchise tax (Pb16 to 17). Petitioner's argument rests on the misperception that it had no employees in New Jersey, or that if it did, the activities of those employees did not extend beyond the mere solicitation of orders. The facts adduced at trial, found by the New Jersey Supreme Court, and recited above at 4 and 12, are plainly to the contrary. Petitioner's employees not only solicited sales in New Jersey, they participated in design conferences in New Jersey, trained customer personnel in New Jersey, and assisted in the repair of petitioner's machinery in New Jersey. It is quite immaterial that petitioner had no office in New Jersey and no other base in New Jersey such that its payroll would be allocable to the State for purposes of the payroll factor of the apportionment formula (*cf.* P.A. 40). Petitioner was able to gain and hold the New Jersey market because its employees came into the State

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* On facts resembling those presented here, this Court, subsequent to its decision in *Container*, has denied review of taxpayer appeals from state court decisions holding their businesses to be unitary. *See Russell Stover Candies, Inc. v. Dept. of Rev.*, 665 *P.*2d 198 (Mont. Sup. Ct. 1983), app. dism'd — *U.S.* —, 104 *S.Ct.* 475 (1983) reh. den. — *U.S.* — (in-state cattle ranch divisions and out-of-state paper box divisions constituted a unitary business where there was a common bank account, centralized management, and mutual dependence); *Associated Dry Goods Corp. v. Commissioner*, 347 *N.W.*2d 36 (Minn. Sup. Ct. 1984), *cert. den.* — *U.S.* —, 105 *S.Ct.* 124 (1984) (corporate divisions formed a unitary business where corporation had a single set of officers and shareholders and there was a commingling of funds and centralized administrative services).

in the course of designing and repairing the sophisticated custom-made equipment which was plaintiff's product, and to train customer personnel in the use and repair of that product (P.A. 16 to 17). In view of these contacts, petitioner was subject to the tax, and 15 *U.S.C.* § 381 (*cf.* Pb18 to 19) does not apply because petitinoner's activities within New Jersey exceeded the mere solicitation of orders.

In short, petitioner has failed to establish that the decision of the New Jersey Supreme Court was not "within the realm of permissible judgment." *Container,* 463 *U.S.* at 176. Nor has petitioner met its "distinct burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed . . . ." *Id.* at 164. Ultimately, the petition exhibits no more than dissatisfaction with this Court's flow of value standard enunciated in *Container* (see Pb21). To the contrary, however, the flow of value standard achieves the common sense result of preventing petitioner from splitting off its sales and investment income from the rest of its business when no one of petitioner's three activities (real estate, security investments and manufacturing/sales) is a discrete or separate business enterprise.

In summary, petitioner has failed to demonstrate any special or important reason to grant its petition in this case. The Supreme Court of New Jersey correctly applied the unitary business principle to the facts and statute before it, and no other question of substantial importance is presented. Accordingly, the petition should be denied.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

N.J.S.A. 54:10A-4(k) defines net income in pertinent part as follows:

(k) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax; provided, however, that in the determination of such entire net income,

(1) Entire net income shall exclude 100% of dividends which were included in computing such taxable income for federal income tax purposes, paid to the taxpayer by one or more subsidiaries owned by the taxpayer to the extent of the 80% or more ownership of investment described in subsection (d) of this section. With respect to other dividends, entire net income shall not include 50% of the total included in computing such taxable income for federal income tax purposes.